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**From:**

**Sent:** Friday, August 14, 2009 4:44 PM

**To:**

**Cc:**

**Subject:** Section 461

As we discussed yesterday, I asked several people in the office whether they had prepared any training materials within the past several years. The attached outline was the only thing available.

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Attachment 1

Section 461 Issues – Economic Performance and Fixed and Determinable Expenses

- I. Inquiries Relevant to the Timing of a Deduction
  - A. Have all the events occurred that establish the fact of the liability?
  - B. Can the amount of the liability be determined with reasonable accuracy?
  - C. Has economic performance occurred with respect to the liability?
  - D. Do any exceptions to the economic performance rules apply?
    - 1. Does the 3 ½ month rule for services and property apply?
    - 2. Does the recurring item exception apply?
  - E. Is the amount deductible under section 162?
    - 1. Is the amount a nondeductible loan or deposit?
    - 2. Is the amount a capital expenditure?
    - 3. If the amount is capital, do any exceptions to the capitalization rules apply (for example, the 12-month rule)?
    - 4. Is the amount deferred/nondeductible under another Code section (for example, section 162(f), 267, 404, etc.)?
- II. Fact of the Liability (section 1.461-1(a)(2)(i))
  - A. The fact of the liability is established at the earliest of when (1) the event fixing the liability, whether that be the required performance or other event, occurs, or (2) payment is due (Rev. Rul. 2007-3 and rulings cited therein)
  - B. “Required performance” issues
    - 1. What is meant by required performance?
    - 2. Must performance be complete?
    - 3. Is this the same test as the required performance test under section 451 for establishing a fixed right to receive income?
  - C. “Other event” issues

1. What is meant by other event?
  2. Can a statutory obligation fix a liability?
  3. Can a contractual obligation fix a liability?
- D. "Due" issues
1. What is meant by due?
  2. Is payment relevant?
  3. Is this the same test as the "due" test under section 451 for establishing a fixed right to receive income?
- III. Reasonable Accuracy (section 1.461-1(a)(2)(i))
- IV. Economic Performance (section 1.461-4)
- A. Services or property provided to the taxpayer (section 1.461-4(d)(2))  
Economic performance occurs as the services or property is provided
  - B. Use of property provided to the taxpayer (section 1.461-4(d)(3))  
Economic performance occurs ratably over the period of use
  - C. Services or property provided by the taxpayer (section 1.461-4(d)(4))  
Economic performance occurs as the taxpayer incurs costs to satisfy the liability
  - D. Liabilities that are assumed in connection with the sale of a trade or business (section 1.461-4(d)(5))  
Economic performance occurs as the amount of the liability is properly included in the amount realized
  - E. Workers compensation, tort, breach of contract, and violation of law; rebates and refunds; awards, prizes, and jackpots; insurance, warranty, and service contracts; taxes; and other liabilities (section 1.461-4(g))  
Economic performance occurs upon payment
- V. Exceptions to Economic Performance
- A. 3.5 month rule (section 1.461-4(d)(6)(ii))  
For services and property provided to the taxpayer, payment is treated as economic performance if the taxpayer can reasonably expect the services or property to be provided within 3.5 months after the date of payment
  - B. Recurring item exception (section 1.461-5)  
A liability is treated as incurred if:
    1. As of the end of the tax year, the liability is fixed and the amount can be determined with reasonable accuracy;
    2. Economic performance occurs before the earlier of when the taxpayer files its return or the 15<sup>th</sup> day of the 9<sup>th</sup> calendar month after the close of the tax year;
    3. The liability is recurring in nature; and
    4. Either the amount is not material, or the accrual in the earlier year results in a better matching with the income to which it relates.
  - C. Issues
    1. Is the liability fixed in the earlier year?
    2. For a service liability, must all the services be completed within the

3.5 months or 8.5 months?

3. Under the 3.5 month rule, are the services provided within 3.5 months after payment (rather than after year end)?
4. Under the recurring item exception, is the liability recurring?
5. Under the recurring item exception, does the accrual of the liability result in better matching?
6. Under the recurring item exception, is the amount of the liability material? What is meant by materiality?